



DIRECTIVE 06-2

April 13, 2006

ANALYSIS OF WHETHER PROPERTY IS REAL OR PERSONAL FOR PROPERTY TAX PURPOSES

Purpose. To provide information to assist in making the determination of whether an item of property should be treated as real or personal property for property tax purposes.

Overview. The question of whether an item of property is considered real or personal has significant implications in how the property is treated for property tax purposes. Real property, other than agricultural land, is required to be valued at 100% of actual value. Neb. Rev. Stat. §77-201(1). Personal property, on the other hand, is valued at its net book value and will eventually depreciate to zero value. Neb. Rev. Stat. §§77-120 and 77-201(5). Statutorily, real property is defined in Neb. Rev. Stat. §77-103 and, relevant to this Directive, subsection (2) includes, "All buildings, fixtures and improvements". However, Nebraska law determining whether an item of property is a fixture or improvement and, therefore, real property as opposed to personal property, has been largely developed by decisions of the Nebraska Supreme Court.

The most significant of those decisions is *Northern Natural Gas v. State Bd. Of Equal.*, 232 Neb. 806 (1989). (Hereafter, *NNG*). In that case, the court determined that underground pipelines for liquid hydrocarbon should be treated as personal property. In doing so, the Nebraska Supreme Court articulated a three-part test in which three questions are asked:

Is the property annexed to the realty?

Is the property appropriated to the use or purpose of that part of the realty with which it is connected?

Is it the intent of the party making the annexation to make the article of property a permanent accession to the real property?

In the *NNG* case, with respect to annexation, the court noted that the pipeline was buried in the ground, but that a significant question of whether an item of property was sufficiently annexed to become real property was whether the property or the real property would be damaged in the removal of the property. In *NNG*, the court determined that the pipe would not be damaged if removed and that the land could be

restored to its original use by simply filling the excavation left behind by digging up and removing the pipe.

The court viewed the appropriation test as asking the question of whether the article of property was a necessary or useful adjunct to the realty. In other words, did the item of property enhance the use and value of the real property? In the *NNG* case, the court determined that the pipeline was not appropriated to the use of the agricultural property in which it was buried because it did not enhance the agricultural use of the property.

The last, and most important, test discussed by the court was the intent of the party annexing the property. Such intent can be inferred from the annexation and the appropriation of the property. It can also be determined by the actions of the annexing party. In the *NNG* case, the court took the view that the property was intended to be treated as personal property because the company owning the pipeline took steps to ensure that title to the property would not pass to the owner of the real estate. The company owning the pipeline also retained possession of the pipes for the purposes of repair, replacement, and recycling. In the court's estimation, the company had exhibited the intent that the pipeline be treated as personal property.

Analysis. Against this backdrop, making the determination of whether property should be deemed real or personal property requires an analysis of the facts surrounding the property in light of the three-part test set forth in Nebraska law. The most important thing to understand about this determination is that it is extremely fact dependent. It is possible that similar property could be classified as real or personal depending on the manner in which it is annexed, whether it is appropriated to the use of the real property to which it is attached, and the intent of the owner. For example, while the *NNG* case determined that pipe carrying liquid hydrocarbon that was buried in agricultural land was personal property, the Department, in Directive 01-7, determined that buried irrigation pipe was, in all likelihood, real property. The difference in treatment related to the tests of appropriation and intent. With respect to appropriation, the pipeline in *NNG* did not enhance the use of the agricultural real property in which it was embedded. Irrigation pipe, on the other hand, is appropriated to the use of the agricultural property in which it is buried because it enhances the agricultural use of the real property. Additionally, the company owning the pipeline in *NNG* made efforts to ensure that it would retain ownership of the pipe. The ownership of buried irrigation pipe, on the other hand, most typically transfers with the sale of the agricultural property, thus indicating that the property is viewed by its owner as real property. The point of this comparison is to be certain that it is understood that the facts of each situation are important to the analysis and that similar property may not always be treated the same way in each situation.

Annexation. This test looks at the manner in which the property is attached to the real property. The more elaborate and permanent the manner of attachment, the more likely it is that the property will be sufficiently annexed to be considered real property. Courts tend to ask whether the removal of the property from the real property to which it

is attached will damage either the property or the real property to which it is attached. For example, a billboard attached to a building in such a way that would require damaging a structural component of the building in order to remove the billboard may be considered real property because of the manner in which it is annexed. If the real property would be altered by the removal of the attached property, the question becomes whether that alteration of the real property is difficult to remedy. Merely filling a hole with dirt has been deemed, in *NNG*, as not being sufficiently difficult to repair to make the attached property real property. It is important to learn as much as possible about the manner of attachment for the property and the difficulties, including potential damage to the attached property or real property, involved in removing the property from its current location.

Appropriation. This test looks at the use of the real property to which the property in question is annexed and asks whether the property adds to the use or value of the real property. To that end, it is important to understand the nature of the property annexed, the use or uses to which the real property may be put and the impact that the property attached may have on the real property. For example, a walk in “beer cave” will likely be deemed appropriated to the use of a convenience store because of the nature of the use of the real property as a convenience store. A billboard may not be appropriated to the use of a large agricultural parcel but may be appropriated to the use of a small parcel along a highway that is not able to be used for other purposes because of the size or irregular shape of the parcel. It is important to gather information about how the attached property is being used as well as the uses of the real property to which it is attached and ask whether the property involved is adding to the use or value of the real property.

Intent. This is the most important of the tests. It can, however, go beyond simply what the owner of the property says about his intent in how the property should be treated. Intent may be inferred from the actions of the owner of the property. For example, if the owner has taken steps to retain title to the attached property, one can infer that the intent is to treat the property as personal. If the property involved is attached to leased real property, yet the property stays in the hands of the original owner at the end of the lease, that indicates an intent to treat the property as personal. If the property stays with the real property, then the intent would seem to be to treat the property as real property. If the owner of the property moves that property or similar property to different locations, that indicates an intent to treat the property as personal property. Additionally, the question of intent is not necessarily removed from market conditions in the industry involved. For example, if real property sells and it is customary in that industry for property that could be deemed personal to go along with the sale without adjustment to the selling price for the inclusion of real property, then the property included in the sale could be deemed real. Built in dishwashers or garbage disposals in apartment complexes fit this category. If the real property has sold recently, a review of the real estate transfer statement to determine the intent of the parties at the time of sale with respect to the treatment of the attached property, while not conclusive on the question, may be useful.

Conclusion. The determination of whether property is real or personal requires the application of a three-part test. The analysis of the annexation of the property, the appropriation of the property to the use of the real property to which it is attached, and the intent of the party annexing the property will hinge on a thorough knowledge of the facts surrounding the type and use of the property involved. Information from the owner of the property, or other sources available to do the analysis will be necessary.

APPROVED

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